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SUBJECT: Microsoft Growing Rapidly in South China

(U) This document is sensitive but unclassified. Please protect accordingly.

11. (SBU) Summary: Microsoft representatives told the Consul General September 21 that with the company's rapid growth in Shenzhen and elsewhere, they expect sales in South China to surpass those in Hong Kong. Company representatives complained about weak copyright enforcement and asked the Consulate to continue to highlight the need for improved IPR protection with local government leaders. End summary.

South China: a fast-growing key market for software

12. (U) The two representatives - Ni Jianbo, General Manager of the Branch Office, and Zhong Weidong, Southern Regional Manager of Microsoft's branch company in Guangzhou - were bullish on the company's overall development and future plans, but more tentative about prospects for protecting Microsoft's intellectual property rights (IPR) in southern China. South China accounts for about 30% of the Microsoft's overall revenues countrywide, of which half comes from Shenzhen. Some of Microsoft's businesses, such as its enterprise partnership group, have grown by 200 times since the establishment of the Shenzhen branch office in 2005. Ni and Zhong believe Microsoft's sales in South China will exceed that of Hong Kong next year, while sales volumes in East China have already surpassed those of Hong Kong and are expected to exceed those of Taiwan next year. The Greater China market (mainland China, Hong Kong, and Taiwan) is so important to Microsoft that it is one of the company's seven key subsidiaries in the world that reports directly Microsoft's headquarters in Seattle.

13. (U) Microsoft's clients in Shenzhen include China's giant telecommunication groups of Huawei Technologies and ZTE (Zhong Xin) as well as local governments. Microsoft established its branch office in Shenzhen to provide a quicker response to local clients, to save operation costs and to better compete with other software companies, such as Oracle, which came much earlier than Microsoft to Shenzhen. Currently Microsoft has three sites in Shenzhen, dealing with sales, technical support, research and development and training.

14. (U) According to Ni and Zhong, Microsoft is building close relationships with the local government in Shenzhen. To demonstrate its long-term commitment to Shenzhen, Microsoft plans to upgrade the branch office into a branch company, which would then pay tax locally instead of to the main office in Beijing, to make more

investments, and to merge its three scattered office sites into one in Shenzhen. Following a nationwide "cooperation" model with local governments, Microsoft is partnering with a local company designated by Shenzhen Government to set up a cooperation program called "MSTC" (Microsoft Training Center) which helps local governments by providing technical support, training, and solutions to e-government projects; this also ensures the use of legal software. In the Guangzhou consular district, Microsoft has opened one MSTC in Xiamen, Fujian Province, is planning to open one in Hainan next month, and has plans to open a center in Guangxi.

Weak IPR enforcement remains a big challenge

15. (SBU) Ni and Zhong commented that while local governments have been making progress in IPR protection, copyright protection for software was a low priority for local officials, particularly in Guangzhou. Zhong said local Copyright Bureau officials focused mainly on developing the local cultural industry, including publishing and audio and video products. Local government agencies have made little effort to enforce the rights of stakeholders in the software industry (both domestic and foreign), despite Microsoft's lobbying efforts during the past several years. According to Zhong, the main reason behind the relative absence of copyright enforcement was that software industry contributes a very small portion of local GDP, the majority of which relies on manufacturing. They also thought that officials might be concerned about the impact of rigorous enforcement on the local business environment since many manufacturers use pirated software. Local officials often do not attend copyright protection seminars or events that industry chambers such as the Business Software Association (BSA) or Chinese Software Association (CSA) organize. Both Zhong and Ni said that the lack of interest in protecting software copyright puts Guangdong at a disadvantage when competing with Shanghai; in addition, lack of

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protection will not help upgrade Guangdong upgrade knowledge-based industries.

16. (SBU) Zhong, who had previously worked in Microsoft's branches in Southwest China for three years, pointed out that officials in those areas were more cooperative than Guangdong. Microsoft was successful in getting enforcement action in Southwest China by adopting a "top-down" strategy to build relations with local provincial and municipal leaders and thus encourage them to order local enforcement agencies to take more action. A similar strategy in South China had not been as successful, though Ni acknowledged this effort was new. In Guangxi, Microsoft got a commitment from the local Copyright Bureau to take two enforcement cases, starting in October. Zhong commented that most enforcement agencies just want a few "showcase" actions they can point to and then do nothing further. Microsoft's goal is to have local agencies do a minimum of two-or-three enforcement showcases to achieve successes and hope this will encourage them to do more. At the same time, the company also realizes that it is impossible for local government to do too many cases, given their limited resources.

17. (SBU) Zhong asked the Consul General to urge local government leaders in Guangdong to be more cooperative in copyright cooperation, since they found "Top-down" strategy is very helpful in other areas where they also first encounter officials unwilling to cooperate.

Comment

18. (SBU) Microsoft's experience in South China highlights regional differences in China's IPR enforcement. Enforcement is often subject to local protectionism. Local officials often believe that enforcement conflicts with the need to develop the economy in order for them to get promoted. Until they can be persuaded that enforcement actually helps development the economy, we will continue to have problems such as those described above.

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